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Taxation That Will Not Impair Business

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PRINCIPLES as to what constitutes fair and equitable taxation are derived, not from theory, but from the traditions, the customs and the standard of justice of a people. American experience has worked out the following principles as to taxation:

1. *Taxes are levied on the basis of ability to pay.* The time was when taxes were shifted from those in ruling power who were able to pay to those without ruling power who were least able to pay. American practice, however, has accepted in full the principle of ability to pay as a test for fair taxes.

2. *The tax collected from the consumer or producer should go to the government.* The exception to this as a rule is the protective tariff. The protective tariff, however, is not so much a tax as a policy, like the tax on oleomargarine. The protective tariff is levied to gain ends other than revenue primarily.

3. *The cost of collection should be as low as is consistent with equity and fairness to different classes of producers and property owners.* Low cost is not the sole test. The tax with the lowest cost of collection is the income tax. To carry the principle of low cost to an extreme would mean primarily to have no taxes other than the income tax. The punitive taxes and corrective or remedial taxes are for an end other than revenue only.

4. *The tax should be equitable, as between country and city, as between different classes of property owners, and as between different sources of income.*

5. *There should be a minimum of duplication in the work and costs of tax collecting agencies on the one hand, and the sources of taxes on the other hand.*

With these principles all will agree. Few will agree in their application. They are the principles, however, that will be kept in mind in the discussion of specific taxes in this article.

THE COST OF NATIONAL GOVERNMENT

In Table I is shown the recapitulation of appropriations for the fiscal years 1920-21 and 1921-22, as given by Senator Warren in the Congressional Record of July 18, 1921.

CAN NATIONAL EXPENDITURES BE REDUCED?

An examination of the appropriations enumerated in this table will show that the outstanding expenditures of the national government are for wars, past, present and future. At the height of our war expenditures, \$9.30 out of every \$10 paid by the taxpayer went for war purposes. At the present time, about \$8.75 out of every \$10 of taxes is going for wars, past, present and future. The tax now paid into the national treasury by the users of tobacco would just about support the legislative, executive and judicial departments of the national government. Roughly speaking, the receipts from amusement and luxury taxes would about support all the other normal activities of the national government. The income tax, the excess profits tax, the corporation tax and the tariff all go for war purposes.

This points the way through which the taxpayer can get relief if he desires it. The extent to which he desires relief will depend on his policy of national protection. Practically the entire increase of the present budget over the 1913 budget is due to the war. Our commitment for interest on the

TABLE I
RECAPITULATION OF APPROPRIATIONS, 1921-22
Sixty-sixth Congress, Third Session, and Sixty-seventh Congress, First Session

<i>Title of acts</i>	<i>Total</i>
REGULAR ACTS	
Agriculture.....	\$36,404,259.00
Army.....	328,013,529.80
Diplomatic and Consular.....	9,326,550.79
District of Columbia ¹	19,512,412.99
Fortifications.....	8,038,017.00
Indian.....	9,761,554.67
Legislative, etc.....	110,348,018.75
Navy.....	410,673,289.23
Pension.....	265,500,000.00
Post Office ²	574,057,552.00
River and harbor.....	15,250,000.00
Sundry civil.....	384,196,480.41
 Total, regular acts.....	 2,171,081,664.64
DEFICIENCY ACTS	
First deficiency, fiscal year 1921.....	275,256,508.87
Second deficiency, fiscal year 1921.....	106,755,657.06
Urgent deficiency, expenses of first session, Sixty-seventh Congress.....	409,065.44
 Total, deficiency acts.....	382,421,231.37
MISCELLANEOUS ACTS ³	
Construction of hospitals, war-risk insurance patients.....	18,600,000.00
Valuation of property of carriers, Interstate Commerce Commission, fiscal year 1921.....	1,000,000.00
Claims of officers and enlisted men of the Army for loss of property lost in the military service.....	300,000.00
Allotment of lands within the Fort Belknap Indian Reservation, Mont.....	270,000.00
Budget and accounting act.....	225,000.00
Sundry miscellaneous acts.....	107,952.58
 Total, miscellaneous acts ³	20,502,952.58
PERMANENTS AND INDEFINITES	
Interest on the public debt.....	922,650,000.00
Sinking fund.....	265,754,864.87
Customs Service, repayments, etc.....	27,000,000.00
Philippine and Porto Rican funds.....	4,000,000.00
National bank examiners, salaries and expenses.....	1,700,000.00
Federal Board for Vocational Education.....	5,438,000.00
Canals and river and harbor work.....	7,244,600.00
Pay of the Army, deposit fund.....	2,000,000.00
Special and trust funds, Navy Department.....	13,040,000.00
Civil service retirement and disability fund.....	5,097,000.00

¹ The amounts for the District of Columbia, after deducting sums for the water service (payable from the water revenues) and sums for playgrounds, street extensions, minimum wage board, and community forums of public schools (payable wholly from District revenues), are payable 60 per cent from the revenues of the District of Columbia and 40 per cent from the Treasury of the United States.

² The expenses of the Postal Service are payable from the postal revenues to the extent they are sufficient therefor and the remainder is paid out of the Treasury.

³ Miscellaneous acts for the Sixty-seventh Congress, first session, include those approved prior to July 1, 1921.

Agricultural and mechanical colleges	\$2,500,000.00
Payments to States from receipts under oil-leasing act.....	3,750,000.00
Indian funds and interest on same	23,300,000.00
Meat inspection, Bureau of Animal Industry	3,000,000.00
Coöperative agricultural extension work	4,080,000.00
Construction of roads and trails, national forests	1,000,000.00
Payments from national forest funds and coöperative work, Forest Service	3,570,000.00
Increased compensation to certain Government employees (\$240 bonus) ¹	35,000,000.00
Miscellaneous	5,651,896.00
Total, permanents and indefinites	1,335,776,360.87
Grand total	\$3,909,782,209.46

RECAPITULATION OF APPROPRIATIONS, 1920-21

Sixty-sixth Congress, Second Session

<i>Title of appropriation acts</i>	<i>Total</i>
REGULAR ACTS	
Agriculture	\$31,712,784.00
Army	392,558,365.00
Diplomatic and Consular	9,218,537.91
District of Columbia ²	20,639,414.87
Fortifications	19,133,442.00
Indian	10,020,555.27
Legislative, etc.	104,749,326.11
Military Academy	2,142,212.70
Naval	438,784,574.00
Pension	279,150,000.00
Post Office ³	462,575,190.00
River and Harbor	12,400,000.00
Sundry civil	437,106,806.92
Total, regular acts	2,220,191,208.78
DEFICIENCY ACTS	
Urgent, fiscal year 1920	33,110,000.00
Second, fiscal year 1920	88,461,889.63
Railroad and urgent, fiscal year 1920	309,717,285.79
Third, fiscal year 1920	55,603,208.03
Total, deficiency acts	486,892,383.45
MISCELLANEOUS ACTS	
Metropolitan and park police, District of Columbia	339,474.05
International Communication Conference	75,000.00
Retirement of school-teachers, District of Columbia	30,000.00
Fire department, District of Columbia	279,500.00
Transportation act, 1920 ⁴	500,050,000.00

¹ This sum is approximated.² The amounts for the District of Columbia, after deducting sums for the water service (payable from the water revenues), and sums for playgrounds, street extensions, and minimum wage board (payable wholly from the District revenues), are payable 60 per cent from the revenues of the District of Columbia and 40 per cent from the Treasury of the United States.³ The expenses of the Postal Service are payable from the postal revenues to the extent they are sufficient therefor and the remainder is paid out of the Treasury.⁴ This sum is made up as follows: \$300,000,000 for new loans to carriers, \$200,000,000 on account of Federal control of railroads, and \$50,000 for expenses of the Railway Labor Board. No amount is included to cover sums estimated to carry into effect the six months' guaranty to carriers or to pay the losses of "short-line" railroads.

RECAPITULATION OF APPROPRIATIONS, 1920-21—Continued

Sixty-sixth Congress, Second Session

<i>Title of appropriation acts</i>	<i>Total</i>
MISCELLANEOUS ACTS—continued	
Relief of certain Army officers	\$10,000.00
Vocational rehabilitation of persons disabled in industry	871,000.00
Federal water-power act	125,000.00
Relief of New Jersey Shipbuilding & Dredging Co.	118,309.16
Miscellaneous private relief acts	55,782.62
Increased compensation to certain Government employees ¹	35,000,000.00
Increased compensation, Postal Service, under reclassification act ¹	41,855,510.00
 Total, miscellaneous acts	 578,809,575.83
PERMANENTS AND INDEFINITES	
Interest on the public debt ¹	1,017,500,000.00
Sinking fund ¹	287,500,000.00
Loans, expenses of ¹	12,456,000.00
Customs Service, repayments, etc. ¹	20,200,000.00
Philippine and Porto Rican funds	4,000,000.00
National bank examiners, salaries and expenses	1,000,000.00
Federal Board for Vocational Education	3,836,000.00
Canals and river and harbor work	4,544,000.00
Pay of the Army, deposit fund	2,000,000.00
Special and trust funds, Navy Department	4,250,000.00
Agricultural and mechanical colleges	2,500,000.00
Indian funds ¹	23,775,000.00
Meat inspection, Bureau of Animal Industry	3,000,000.00
Road construction ²	104,000,000.00
Miscellaneous ¹	12,846,752.29
 Total, permanents and indefinites	 1,503,407,752.29
 Grand total ²	 \$4,789,300,920.35

¹ This sum is approximated.² This sum includes \$78,000,000 appropriated for the construction of roads for the fiscal year 1921 by the Post Office appropriation act approved Feb. 28, 1919.

present public debt alone (\$923,000,000 in 1920-21) is about double the annual cost of our national government before the war.

INTEREST ON ALLIED DEBTS

The tax burden on the American taxpayer could be reduced about half a billion dollars a year should we require our allies to pay the interest on the ten billion dollars advanced by our national government to them for war purposes. There is a general concensus of opinion that we could not collect this interest now if we would. It is equally obvious that we would not now collect

it if we could. This interest can be paid only in goods, and certainly at present price levels, goods in addition to those required for exchange of our surplus products are not desired from European countries. Such a flow of goods could only depress prices further. Taxpayers, therefore, can look for little immediate relief from this direction.

EXEMPTIONS FROM TAXATION

The national government during the war period adopted two fallacious policies that are largely the cause of our present industrial ills. The first of

these was to put the interest rate on public bonds as low as it was. We have paid a reasonable interest rate over and over in the form of higher prices and hence in larger public debts consequent upon inflation. The second error was to exempt certain national bonds from taxation. Professor Edwin R. Seligman has estimated that local, state and national governments are now losing about \$600,000,000 a year through the exemption from taxation of our \$24,000,000,000 of federal debt, and \$8,000,000,000 to \$10,000,000,000 of state and local securities. Obviously the Federal Government can now do little to redeem this error as to past issues. Business men, however, should make certain that the error is not repeated. In view of the fact that under our constitution the states and the national government are each sovereign in their own fields it would be impossible, by national law, to prohibit the states from exempting state and municipal securities from state and local taxation. And the importance of preserving the autonomy of our states in their own fields would make inadvisable a national constitutional amendment attaining the same ends. The taxpayer must see to it hereafter that public securities are not exempt from taxes. He can now get little consolation from that source in the way of reducing present tax levies.

READJUSTMENT OF THE BURDENS OF TAXATION

Assuming no substantial change in our war expenditures and assuming a reasonable funding of our short term national debts, we now need about four billion dollars a year for the national government. The present taxes will yield just about this sum in 1922. There is, therefore, no special need for additional sources of revenue. The only issue now is as to whether there

should be better readjustment of the existing burdens of taxation.

EXCESS PROFITS TAX

Many thousands of dollars have been spent in propaganda to the effect that the excess profits tax increased the cost of living. The argument was that the corporations subject to the tax added to their prices not only the tax, but several other imaginary costs along with the tax. Recent events have shown the fallacy of this argument even to its most obdurate friends. Whatever may happen in a seller's market, it is clear from recent events that the excess profits tax does not prevent a fall in prices. In a seller's market some may accept the glib theory that price is a question of mathematics; that the tax is merely added in with all its incidental costs and risks as one of the elements in price and hence the consumer bears the burden no matter what the form of the tax. This argument has proved groundless, not only as to the excess profits tax, but as to the income surtaxes as well. When the marginal producer is exempted, as he is in both the income and excess profit taxes, and when a price is fixed under fair competition, there can be no adding such taxes to the price. The excess profits tax is now more an exemption tax than a tax levy. Many of the former opponents of the tax may shortly find themselves in the position of favoring it in preference to the alternatives.

The concensus of opinion, however, now is that the excess profits tax is to go, not because it adds to the cost of living, but because it is difficult to ascertain and because it is inequitable as between businesses whose invested capitals were acquired, let us say, before the war and during the war.

There is unanimity of opinion, also, that the higher surtaxes should be re-

pealed down to the limit of 40 per cent. This is rendered advisable particularly in view of the large field of tax-exempt securities into which such income groups may put their money.

What taxes shall take the place of the excess profits tax, which under the present industrial conditions is ceasing to pay substantial sums into the Treasury anyhow, and what taxes shall take the place of the receipts from the higher brackets of surtaxes? There are really two alternatives for serious consideration. One is the sales tax, and the other is a graduated tax on the income of corporations.

Certainly under present conditions of widespread unemployment and of a reduced purchasing power among our farmers below that of many decades, no statesman will seriously champion an extension of consumption taxes.

A graduated corporation tax is preferred to the sales tax by the author of this article for the following reasons: 1. It is based on ability to pay. 2. It will give an equitable taxation as between individuals and partnership on the one hand, and corporations on the other. And this, American practice has insisted upon; indeed, we have in too much of our state legislation put heavier tax burdens on corporations.

OBJECTIONS TO SALES TAX

The sales tax, in any form proposed, whether a turn-over tax or a tax on retail sales only, violates the cardinal principle of ability to pay. The tax would be paid by the bankrupt as well as by the individual or corporation with a net income. Such a tax would retard the moving of stocks put in at higher prices, and hence is peculiarly unfitted to the present industrial situation. It would be unjust as between competitors in the same industry depending on the degree of integration in the various industries. It would be

particularly odious and heavy in those industries where the turnover would be rapid in proportion to capital invested. More important still, it is an indirect tax, to a certain extent, and if adopted would abide with us to an extent that a direct tax would not. The direct tax has the distinct advantage of making those who pay it watchful of governmental expenditures and governmental efficiency. We have had already expensive experiments with taxes that were not felt because not paid directly. Business men will find that the sales tax will not be shifted in all instances as so many are now prone to believe. Consumption taxes on necessities have been before the American people in a number of ways, and have always been settled adversely. French and English experience is replete with attempts to collect a tax on everything, and such general taxes have invariably been abandoned for the income tax, the inheritance tax and other means of getting directly at the source of wealth at little cost.

THE TARIFF

Before we can have an exchange situation that will allow us to find an export market for our surplus goods, we must have a flow of goods into this country. Moreover, if we are to collect in due time the interest on private debts and on public debts due from other countries, we must expect a flow of goods from those countries to pay this interest. To put on a general protective tariff that will exclude these goods is as short-sighted as the old English policy of putting the debtor in prison. Certainly we have passed beyond this point in our understanding of national economics. Our entire situation has changed. Instead of being a debtor nation, we are now the world's great creditor nation, and our tariff policy must be shaped accordingly. Tariff

policies we must have in order to meet the tariff policies of other countries, if for no other reason. And for national policies we may well adopt high protective tariffs on selected commodities. But in general the tariff must now be levied more with the thought of revenue than with the thought of prohibition of imports in order to raise prices on domestic goods.

NUISANCE TAXES

One sound principle of taxation is that the tax collected from the consumer should go on to the government. Those who buy fountain drinks are all aware that the tax is always collected. It is equally clear that not nearly all of this tax gets on to Uncle Sam.

The excise tax on certain commodities has been an American policy and will no doubt be continued. These excise taxes, however, should be levied on articles and under conditions so that the tax paid by the consumer really gets to the government. This can be done with the tax on tobacco and with many of the taxes on luxuries. Reasonable taxes on habits do not stop production.

There should be a readjustment of our excise taxes with these principles in view, and also with the principle of ability to pay in mind. This is particularly important to business men under present conditions of widespread unemployment.

THE ESTATE TAX

Our estate tax is new to our national experience. The tax is not as heavy as that levied in other countries, and offers an opportunity for expansion, if expansion be needed under the readjustments discussed above, to meet the national requirement of four billions a year. The estate tax is not a burden on production, nor at reasonable rates will it

stifle incentive. It is based on ability to pay and the cost of collection is low.

SUBSIDIES

The preceding arguments assume that we will not heavily subsidize any special groups or industries in the country, whether they be former soldiers, or transportation companies or private owners of merchant ships. The taxpayer has found out that the prevention of burdens is the best way to reduce taxes. Groups of all kinds will want subsidies directly or indirectly and all groups will accept the subsidies if they can get them. Eternal vigilance is the taxpayer's only protection in this matter. Those who want subsidies organize to get them. The taxpayers will prevent their getting them only with equally good or better organization.

STATE AND LOCAL TAXES

The total and per capita expenditures of all the states are given in Table II. An examination of this table will show that out of the \$8.60 spent per capita for the governmental cost of all the states in 1918, fifty cents per capita went to the general branches of state governments. We probably will not find that this particular expense can be measurably lowered. Neither will the thirty-two cents per capita for protection to personal property be materially lowered. When measured in service, certainly, no one will begrudge the twelve cents per capita spent on conservation of health and sanitation. Few, too, will begrudge the services rendered by the \$1.20 spent in the development of our agricultural and other national resources. Our state expenditures of thirty-eight cents per capita for highways will no doubt be increased rather than decreased, in order to make way for

TABLE II
GOVERNMENTAL COST PAYMENTS BY ALL STATES—1918

	1918	Per Capita	Dist.	
			Gen. Dept.	Total
			Per Cent	Per Cent
I. General Departments				
A. General Government	51,395,182	0.50	10.8	
B. Protection to Person and Property				
1. Militia—Armories.....	9,192,685	0.09	1.9	
2. Regulation.....	17,524,592	0.17	3.7	
3. All Other	6,501,658	0.06	1.4	
C. Conservation of Health and Sanitation				
1. Prevention and Treatment of Communicable Disease	7,237,723	0.07	1.5	
2. All Other	5,011,610	0.05	1.1	
D. Development and Conservation of Natural Resources				
1. Agriculture.....	17,061,201	1.16	3.6	
2. All Other	4,572,771	0.04	1.0	
E. Highways	38,828,799	0.38	8.2	
F. Charities, Hospitals and Corrections	118,084,025	1.14	2.49	
G. Education				
1. Schools	168,183,641	1.59	34.4	
2. Libraries	1,268,602	0.01	.3	
H. Recreation	1,248,094	0.01	.3	
I. General	32,851,140	0.32	6.9	
Total General Departments	473,961,723	4.58	100.0	83.7
II. Interest				
A. On Funded Debt	19,840,936			
B. " Floating Debt	2,411,497			
C. " Other Debt	826,414			4.3
	23,078,847			
III. Expenses Pub. Ser. Enter.....	2,300,403	.02		.40
IV. Outlays	66,144,964	.63		11.6
Total	565,485,937	5.43		100.0
NON-GOVERNMENTAL COST PAYMENTS BY STATES—1918				
I. Payments for Purchase of Invest.....	84,896,490	.80		25.0
II. Payments which decreased Indebtedness ..	116,126,235	1.12		35.0
III. All Other	129,160,620	1.25		40.0
	330,183,345	3.17		100.0
RECAPITULATION				
Governmental Cost	565,485,937	5.43		63.0
Non-Governmental Cost	330,183,345	3.17		37.0
Total	\$895,669,282	8.60		100.0

increasing motor traffic and in order to open up the market from farm to consumer. The \$1.14 per capita which we spend for hospitals, charities and correction is about the cheapest insurance we carry. And no one will want to reduce the \$1.61 per capita spent for schools, libraries and recreation. Certainly we do not want to lower the

service received for these expenditures. We do, if possible, want those services at less cost.

Table III shows the per cent of distribution of the general departmental expenses of all cities of 30,000 or over from 1903 to 1918. This table gives the per cents, and not the totals, but the uniformity of the per cents

TABLE III

COMPARATIVE SUMMARY OF PER CENT DISTRIBUTION OF GENERAL DEPARTMENTAL EXPENSES OF ALL CITIES OVER 30,000 FOR SPECIFIED YEARS 1903-1918

Object of Payment	1918	1917	1915	1913	1911	1909	1907	1905	1903
General Government.....	10.7	11.5	11.4	11.6	11.8	12.2	11.7	10.0	11.1
Police Department.....	10.9	11.0	11.3	11.6	12.0	12.6	12.4	13.3	13.6
Fire Department.....	8.3	8.5	8.8	9.1	9.5	9.8	9.6	10.1	9.8
All other Protection to Person and Property.....	1.8	1.9	1.9	1.9	1.9	1.8	1.8	1.9	1.9
Conservation of Health.....	2.6	2.5	2.2	2.0	1.9	1.9	1.8	1.6	1.7
Sanitation or promotion of Cleanliness.....	7.8	7.6	7.9	8.1	8.2	8.1	8.1	8.1	7.5
Highways.....	10.1	10.4	11.2	11.2	11.6	10.6	12.0	12.0	12.4
Charities, Hospitals, and Corrections.....	7.4	7.2	6.8	6.4	6.6	6.9	6.6	6.3	6.5
Schools.....	31.4	31.1	30.2	28.9	28.6	28.2	27.7	28.7	29.3
Libraries.....	1.3	1.3	1.3	1.3	1.3	1.5	1.3	1.4	1.5
Recreations.....	3.5	3.5	3.7	3.7	3.7	3.5	3.2	3.4	2.7
Pensions and Gratuities.....	2.2	2.2	1.9	1.7	1.6	1.5	1.4	1.2	1.1
All Other.....	1.9	1.3	1.4	2.5	1.4	1.3	2.2	2.0	1.0

of the total appropriations will indicate that our policy in these expenditures has been consistently worked out over a period of years, and hence offers little possibility for downward revision, so far as service rendered is concerned.

When measured in terms of services, we shall not expect less from our city and state governments.

Can we get these services at lower costs? We can in certain ways. Some savings can be made in lost motion by further centralizing bureau organization in the national govern-

ment. But these savings cannot offset increased costs over a pre-war base. We will see what Mr. Dawes can do.

The dark continent of American administration is in the organization of our state governments. In most of our states we have not one governor but several score of them. Much real progress has been made in the last twenty years in putting city administration on a well organized basis.

Constructive public expenditures that return services for money received do not impair business.

Changing the Fundamental Structure of the Federal Reserve System

By HOMER JOSEPH DODGE
Editor, Federal Trade Information Service

THE delight which statesmen, politicians and economists find in experimenting with the money systems of the world is the root of a large proportion of business evils. Whether it is because the use of money plays so

large a part in American life, or whatever the cause, the monetary system of the United States has been the victim of almost ceaseless experimentation. This tinkering has not come to an end with the erection of the Federal